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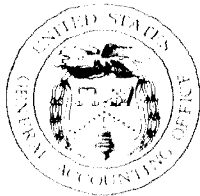
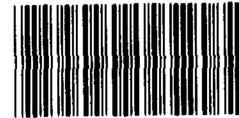
Report to the Chairman, Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, House of Representatives

June 1991

FOREIGN INVESTMENT

Concerns in the U.S. Real Estate Sector During the 1980s





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Washington, D.C. 20548

National Security and
International Affairs Division

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June 4, 1991

The Honorable John D. Dingell
Chairman, Subcommittee on Oversight
and Investigations
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

This report is the last in a series responding to your request that we examine the effects of foreign direct investment in the United States. This report analyzes trends in foreign direct investment in U.S. commercial real estate and evaluates concerns about the effects of such investment.

The first three reports in this series were Foreign Investment: Federal Data Collection on Foreign Investment in the United States (GAO/NSIAD-90-25BR, Oct. 3, 1989); Foreign Investment: Analyzing National Security Concerns (GAO/NSIAD-90-94, Mar. 29, 1990); and Foreign Investment: Concerns in the Banking, Petroleum, Chemicals, and Biotechnology Sectors (GAO/NSIAD-90-129, May 30, 1990).

We plan no further distribution of this report until 30 days from the date of this letter unless you publicly announce its contents earlier. At that time, we will send copies to other interested parties. Copies will also be made available to others on request.

Please contact me on (202) 275-4812 if you or your staff have any questions concerning this report. The major contributors to this report are listed in appendix III.

Sincerely yours,

Allan I. Mendelowitz

Allan I. Mendelowitz, Director
International Trade, Energy,
and Finance Issues

Executive Summary

Purpose

Increased foreign direct investment in U.S. real estate has attracted public attention and raised concern about the consequences of foreign ownership of U.S. property. The Chairman, Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, asked GAO to examine the effects of increased foreign direct investment in the United States. This report is one of a series responding to that request and focuses on the commercial real estate sector. In this report, GAO (1) analyzes trends in foreign direct investment in U.S. commercial real estate during the 1980s and (2) evaluates specific concerns about the effects of such investment, including selected regional markets where such investment was concentrated.

Background

As the real estate industry has gradually globalized, foreign ownership of U.S. real estate has increased. This increase is only one part of the broader inflow of foreign capital due to macroeconomic forces. For investors seeking a safe haven for their capital or diversifying their investment portfolios, the United States has provided an attractive investment climate as well as abundant investment opportunities. The U.S. real estate market in particular has attracted foreign investors due to its openness and size, its relatively high rate of return on investments, its value as a hedge against inflation, and its tax benefits.

Results in Brief

The foreign direct investment position, or accumulated foreign direct investment capital, in the U.S. commercial real estate sector increased fourfold over 9 years to $35.85 billion in 1989, with a major share of the increase coming from Japanese investors. However, foreign affiliates owned only around 2 percent of the value of total U.S. commercial property in 1988 (the latest year for which these data were available).

Foreign investors' real estate purchases have focused on "investment grade" office buildings and hotels, generally in downtown locations in major cities. Purchases also included a few regional shopping centers and resorts in prime locations. Thus, foreign investments were concentrated within a narrow market segment where, as a result, prices rose rapidly. However, foreign investment slowed with the downturn in the U.S. market in late 1989.

Foreign investment in U.S. commercial real estate gained much media attention and sparked public concern about its effects. The first concern was that high concentrations of foreign investments were leading to

excessive price increases for investment-grade properties. While the precise impact of such investments is difficult to assess, industry experts generally consider foreign investments, in the aggregate, to be beneficial. They are a source of stable, long-term capital that does not threaten national security. A second concern was that foreign competition for market share in the commercial real estate development and construction industry was increasing, and certain foreign investors were believed to have financial advantages. Analysts believe that such concerns are often overstated and that the industry generally welcomes foreign investment capital.

In addition, there were particular concerns at the state and local level in those areas where investments were concentrated, most notably in Hawaii, where increases in property prices and tax assessments and decreases in housing availability were worrisome. Although foreign investments may have significantly contributed to these effects, they were not the only factors involved.

Principal Findings

Japanese Led Surge in Foreign Holdings

Foreign holdings of U.S. real estate sharply increased during the 1980s, led by Japanese investors. Even so, total foreign direct investment in real estate maintained a constant share of 9 to 10 percent of total foreign direct investment in all sectors during most of this period. Japan, the United Kingdom, Canada, the Netherlands, and the Netherlands Antilles had the largest foreign direct investment positions in commercial real estate in 1989, together accounting for 83.9 percent of the total. Japan had by far the highest rate of increase, surging from a modest share in 1981 to $14.3 billion, or 40 percent of the total in 1989, far surpassing the second-ranking United Kingdom.

Foreign direct investment in U.S. commercial real estate generally flowed to large metropolitan cities and was concentrated in high-value, high-profile, investment-grade properties. Over time, as opportunities to purchase such premier properties diminished, foreign investors turned from first-tier to second-tier cities and from central business districts to suburban locations. When the U.S. commercial real estate market experienced a serious downturn in late 1989, foreign investment also slowed as a result of factors both internal and external to the United States.

There were high concentrations of foreign investment in the commercial real estate sector in Hawaii, California, and New York. In Hawaii, foreigners invested at least $4.1 billion in the sector from statehood in 1959 through 1987, with about 52 percent taking place in 1986 and 1987. Japanese affiliates accounted for 90.1 percent of foreign-held Hawaiian commercial property in 1988. In California, foreign investors initially concentrated their buying in the central business districts of Los Angeles and San Francisco but then shifted attention to other areas such as San Diego and Orange County. By 1988, foreign holdings of commercial property reached $18.7 billion, with the Japanese, British, and Canadians holding 29.1 percent, 21.1 percent, and 13.6 percent, respectively. In New York, foreign interest centered on New York City's landmarks and prestigious addresses. The $15-billion foreign investment in commercial property in the state in 1988 was dominated by the Canadians (29.1 percent) and Japanese (25.6 percent).

Foreign Investment Raises Two Main Concerns

There were two major concerns about foreign investment in U.S. commercial real estate. The first was that high concentrations of foreign investments within a narrow, high-value market segment for premier properties might increase demand beyond available supply and raise the prices of similar properties. Any assessment of this concern is difficult because it must take into account that the costs and benefits involved accrue to different parties. For example, the large volume of foreign investments bid up prices, causing some domestic investors to be priced out of the first-tier market. Conversely, property owners profit from the appreciated value of their holdings.

Industry analysts and academic experts believe that, overall, foreign investment in U.S. real estate is beneficial. They say that this investment constitutes a source of stable, long-term capital; that it cannot be quickly disposed of or removed from the country; and that it does not involve national security concerns or transfers of high technology. Analysts also state that the U.S. real estate market is generally too large and broad to be overwhelmed by outside control. They add that the inflow of foreign capital helped to enhance the value of U.S. commercial property markets by providing needed liquidity.

The second concern was about increasing foreign competition in the commercial real estate industry itself, especially where foreign investors were perceived to have financial advantages. These advantages included easier access to capital because of close ties to banks and lower borrowing costs than U.S. investors had. Foreign real estate development

and construction companies were also interested in gaining American market share in the increasingly internationalized real estate industry. Analysts nevertheless said that concerns about increased foreign competition were often overstated. They believe that foreign investment capital is generally welcome, especially by U.S. developers able to access foreign capital through joint ventures. Analysts also said that because real estate is such a local industry, there is no comparative advantage that can accrue to foreign firms.

Regional Concerns Exist in Hawaii, California, and New York

Public concerns about foreign investment in real estate were also voiced regionally, particularly in Hawaii, California, and New York. However, most state and local officials GAO contacted in California and New York, as well as most industry analysts GAO interviewed, generally stated that this concern was not warranted. In Hawaii, which has experienced a relatively high level of foreign investment, state and local officials voiced deep concerns about the effects on real estate, including the strain on the state's infrastructure, the potential alteration of the islands' unique character, and the effects of increased golf course development.

Recommendations

This report contains no recommendations.

Agency Comments

As requested, GAO did not obtain written agency comments. However, GAO did obtain views of responsible officials during its work, and their comments have been incorporated where appropriate.

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Abbreviations

BEA	Bureau of Economic Analysis, U.S. Department of Commerce
GAO	General Accounting Office
MIT	Massachusetts Institute of Technology

Introduction

In recent years, the dramatic increase of foreign direct investment in U.S. real estate, a highly visible sector, attracted much national attention. The growth in foreign ownership of U.S. real estate resulted from the globalization of the real estate industry and was part of the broader inflow of foreign capital due to macroeconomic forces. For many investors seeking a safe haven for their capital or desiring to diversify their investment portfolios, the United States provided an attractive investment climate, as well as abundant investment opportunities, particularly in U.S. real estate.

Some of the factors that facilitated the globalization of the U.S. economy in general also affected the U.S. real estate sector in particular. These factors included the progressive liberalization of world capital markets, technological advances in telecommunications and information processing, and macroeconomic conditions encouraging an inflow of investment capital into the United States.

Foreign investors found U.S. commercial real estate to be attractive for various reasons, including the desire to diversify investment portfolios, the openness of the property market, the relatively high returns on investment, and the opportunity for foreign real estate firms to establish or increase market share.

Factors Aiding the Globalization of the Real Estate Sector

As the U.S. economy has become increasingly internationalized in recent years, so, too, has the U.S. real estate sector. The major industrial nations progressively liberalized world financial markets, removing restrictions on capital flows into and out of their domestic financial markets. This liberalization enabled foreign investors to transfer capital abroad in order to diversify their investment portfolios; many chose to buy U.S. real estate.

Also, technological progress in fields such as telecommunications, computing, and information processing allowed almost instantaneous data transmission around the world. This capability lowered financial transaction costs and fostered a financial environment in which capital could rapidly flow from one country to another, seeking the highest yield. As a result, foreigners had greater access to the attractive U.S. real estate market.

In addition, macroeconomic conditions created an environment that encouraged an inflow of foreign capital to the United States. The U.S. savings and investment imbalance caused by the federal government's

budget deficit meant that the United States had to import capital from other countries. Meanwhile, other countries that had built up large current account surpluses, such as Germany, Japan, and Taiwan, had more capital available than their economies consumed. These factors caused investment capital to flow into the U.S. economy, including the real estate sector.

Attraction of U.S. Real Estate for Foreign Investors

U.S. commercial real estate was particularly attractive to foreign investors for several reasons. First, it offered diversification of their investment portfolios. Second, its openness, size, and steady growth facilitated entry into the U.S. real estate market. Third, U.S. property ownership was considered beneficial due to its relatively high yields, its value as a hedge against inflation, and its tax advantages. Finally, the real estate industry was globalizing, and foreign firms wanted to expand to the U.S. market, the world's largest in size, and establish market share.

Diversification

Foreign investors, especially large institutional investors such as pension funds or insurance companies, found it prudent to diversify holdings outside of their national borders. In this way, their assets would not be fully tied to the economic health of a single nation's economy. Similarly, they wanted to diversify from portfolio holdings, such as stocks and bonds, to direct investments. Direct investments were seen as particularly important in the aftermath of the October 1987 U.S. stock market crash, when the market lost almost one quarter of its value in a single day.

Availability of Options and Relatively High Turnover

The U.S. commercial real estate market is notable for its openness and extensiveness. Industry experts state that it offers a wide array of investment options unmatched in size and scope by any other market in the world. Foreign investors are not restricted or scrutinized in their property purchases by U.S. authorities, providing great ease of entry into the market. The market also constitutes the world's largest supply of investment-grade real estate. In addition, the market includes many major cities that are well known internationally. In many other countries, the commercial real estate market tends to be dominated by a single area (i.e., London or Tokyo), with strict government controls on growth and development.

The U.S. commercial real estate market is also notable for its relatively high turnover rate, compared to other countries. One reason for this

turnover is that a much higher proportion of properties in the United States is controlled by individuals or families, as opposed to institutions. As a result, U.S. property changes ownership more often than does property in other countries, offering tremendous selection, according to the National Association of Realtors. In Japan, most investment-grade buildings are owned by large institutions that rarely sell real estate holdings; such sales might be taken as a sign of institutional weakness. In Europe, there is also an institutional tendency to hold on to property.

Another reason for the high turnover rate of U.S. property in the late 1980s, according to the National Association of Realtors, was that publicly traded companies whose stocks had been trading below their net asset value, or actual company worth, were under great pressure from the market to restructure. By doing so, these companies hoped to close the gap between net asset value and share price. A primary impetus in such cases was to avoid takeovers. Often these restructurings involved selling real estate assets that were undervalued on a company's books in order to place profits on the company's accounting sheet.

Another factor relevant to the high turnover rate was that the Tax Reform Act of 1986 motivated many American holders of real property to sell at the end of 1986 to avoid the 40-percent increase in the tax rate on capital gains effective January 1, 1987. Therefore, many properties went on the market and became available to foreign investors.

Advantages of U.S. Real Estate Ownership

Owning U.S. commercial real estate has provided many advantages, according to industry analysts. One important advantage has been that income-producing property in the United States commonly has shown higher yields than have similar investments abroad. U.S. yields of 8-10 percent compared very favorably to yields of 1-2 percent in Japan or 4-6 percent in Europe during the late 1980s. In 1990, though, U.S. yields fell to around 6-8 percent, while yields in Europe went up to around 7-8 percent. However, yields in the U.S. market are still attractive for many foreign investors.

Another advantage has been that U.S. real estate assets, such as office buildings, shopping centers, and industrial properties, have traditionally provided an excellent hedge against inflation because of the way in which their operating costs are structured. Leases usually stipulate that increases in operating costs are to be passed along to tenants. Increases in rents are also normal at the end of a lease. Furthermore, leases of shopping centers often provide for the owner to receive a percentage of

the tenants' sales in addition to a base rent. This arrangement partially indexes income to inflation.

There have also been tax advantages in owning U.S. real estate. The 1986 Tax Reform Act reduced the tax benefits available to owners of income-producing property. According to the National Association of Realtors, however, tax treatment of real estate in the United States was still more favorable than in other countries because depreciation schedules were shorter and income tax rates were lower.

Desire to Gain U.S. Commercial Real Estate Sector Market Share

Investment in U.S. real estate has also been attractive for foreign investors due to the increasing globalization of the commercial real estate industry. Because the United States is the world's largest and most open commercial real estate market, foreign firms want to establish market share here. Thus, buying U.S. real estate has been as much a business expansion decision as an investment decision for some foreign investors. First, they learn the market as investors, and then they build businesses here in real estate development, design, construction, property management, or brokerage. Since the U.S. real estate market is not actually one national market but numerous local markets, foreign firms need to become familiar with a particular local market before they can be competitive in it. For this reason, many foreign firms have established joint ventures with experienced U.S. companies.

Objectives, Scope, and Methodology

The Chairman, Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, asked us to examine the effects of increased foreign direct investment in the United States. This report is one of a series of reports responding to that request. Our objectives in this report were to identify and assess concerns about the effects of foreign direct investment in the U.S. real estate sector. We focused on (1) analyzing trends in foreign direct investment in U.S. commercial real estate during the 1980s and (2) evaluating specific concerns about the effects of such investment, including the effects on selected regional markets where such investment has been concentrated.

To identify potential investment issues relating to the real estate industry, we reviewed a broad range of literature, including real estate and investment industry journals. We obtained available private sector studies on foreign direct investment in U.S. real estate. We also talked with academic and industry experts and with federal officials responsible for following this sector. To learn what is known at the state level

about the extent and effects of foreign investment in real estate, we interviewed a variety of state government, academic, business, and trade association representatives in three states that have significant levels of foreign direct investment: Hawaii, California, and New York.

We performed our work from July 1988 to December 1990 in accordance with generally accepted government auditing standards. As requested, we did not obtain formal agency comments on this report. However, we obtained the views of responsible officials during our work, and their comments have been incorporated in the report where appropriate.

Trends in Foreign Direct Investment in U.S. Commercial Real Estate

Foreign holdings of U.S. real estate have increased sharply in the last decade. No federal agency has oversight responsibility for the real estate sector; however, the Commerce Department's Bureau of Economic Analysis (BEA) collects data about foreign ownership of U.S. real estate as part of its "Foreign Direct Investment in the United States" data series. These data are the most comprehensive and complete data currently available. (See app. I.)

BEA provides data on foreign real estate holdings in two categories: (1) the commercial real estate sector, including ownership of real estate businesses, as well as property, and (2) commercial property ownership across all sectors of the economy, including manufacturing or services sectors. BEA established the latter category for commercial property data for the first time in its Foreign Direct Investment in the United States: 1987 Benchmark Survey, published in August 1989. Previously, BEA had only collected data for the real estate industry sector.

BEA's commercial real estate sector data show significant increases in foreign direct investment in the U.S. real estate sector from 1981 through 1989. The data include statistics on the tremendous surge in Japanese real estate investments after 1985, which led Japanese investors to play a central role in the U.S. market. The new commercial property data cannot yet indicate trends; however, they have provided important new information on the nature and extent of foreign holdings in 1987 and 1988. A November 1988 private sector study also supplied detailed knowledge about patterns of behavior by foreign investors in the American real estate market. Foreign investments have been particularly heavy in Hawaii, California, and New York. However, the U.S. commercial real estate market has declined recently, slowing down foreign investments, according to industry experts.

Significant Increase in Foreign Investment in U.S. Real Estate

The increase in foreign holdings of U.S. real estate during the past decade was evident not just from press reports of purchases of landmark buildings or prestigious addresses (sometimes referred to as "trophy" or "signature" properties), but also from every measure of foreign direct investment the BEA tracks. The commercial real estate sector data show that the foreign direct investment position in the United States increased fourfold, from $9 billion in 1981 to $35.85 billion in 1989. (See table 2.1.)

Table 2.1: Foreign Direct Investment Position by Country in the U.S. Commercial Real Estate Sector, 1981-1989

Dollars in millions

Country	1981	1982	1983	1984	1985	1986	1987	1988	1989
All countries[a]	$8,964	$11,520	$14,636	$17,761	$19,402	$22,512	$27,516	$31,929	$35,853
Canada	1,743	1,881	2,274	2,844	2,750	3,320	4,417	4,169	3,921
Europe (total)	3,721	5,119	6,835	8,255	8,921	9,821	10,379	10,532	11,330
France	24	24	24	66	41	57	57	95	73
Germany	650	778	893	966	1,100	1,133	1,143	1,079	1,173
Netherlands	1,554	1,821	2,254	2,471	2,212	2,614	3,311	3,340	3,410
United Kingdom	1,221	2,060	3,196	4,135	4,764	5,211	5,140	5,323	5,234
Switzerland	149	300	328	393	447	456	391	388	370
Japan	305	396	515	744	1,536	2,941	6,098	10,017	14,294
Australia, New Zealand, & South Africa	55	60	70	120	122	235	329	416	379
Latin America	2,617	3,308	4,068	4,664	4,881	4,786	4,802	5,217	4,223
Netherlands Antilles	1,915	2,566	3,244	3,715	4,065	3,915	3,588	3,190	3,239
Middle East	363	544	602	709	738	954	870	923	936
Other Africa, Asia, & Pacific	160	212	273	423	453	456	621	655	770
OPEC (Addendum)[b]	376	555	614	707	726	933	837	879	883

Legend

OPEC = Organization of Petroleum Exporting Countries

[a]Subtotals may not add up to total for all countries due to rounding.

[b]This is a memorandum entry and should not be included in adding together individual items to reach a total for all countries.

Source: BEA, Foreign Direct Investment in the United States: Detail for Position and Balance of Payments Flows, 1984, and subsequent articles for 1985, 1986, 1987, 1988, and 1989; Survey of Current Business, August 1985 and subsequent issues for August 1986, 1987, 1988, 1989, and 1990.

This influx of foreign direct investment capital into the real estate industry should be placed in context, however. Although the level of foreign investment in U.S. real estate dramatically increased during the 1980s in absolute terms, it maintained a relatively constant share of total foreign investment in all sectors during that time. Table 2.2 shows that the foreign direct investment position of the commercial real estate sector was generally close to 9 or 10 percent of the amount for all sectors from 1981 to 1989. In addition, the BEA's new commercial property data pinpointing commercial property holdings across all sectors show that the value of foreign investment in commercial property was 9.5 percent of total assets held by foreign investors in 1987 and 8.7 percent in 1988.

Table 2.2: Foreign Direct Investment Position in All U.S. Sectors and in the Commercial Real Estate Sector, 1981-1989

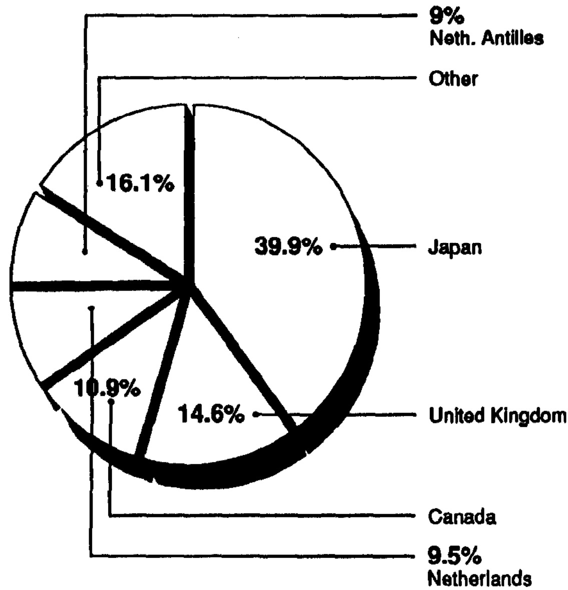
Dollars in millions

Year	Foreign direct investment in all sectors	Foreign direct investment in commercial real estate sector	Commercial real estate's share of total foreign direct investment (percent)
1981	$108,714	$8,964	8.2
1982	124,677	11,520	9.2
1983	137,061	14,636	10.7
1984	164,583	17,761	10.8
1985	184,615	19,402	10.5
1986	220,414	22,512	10.2
1987	271,788	27,516	10.1
1988	328,850	31,929	9.7
1989	400,817	35,853	8.9

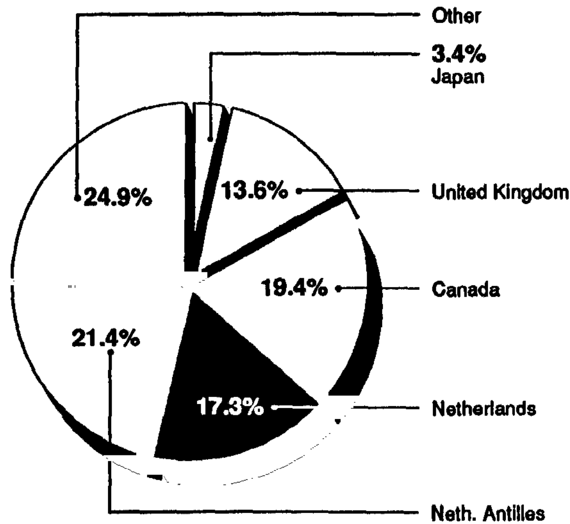
Sources: BEA, Foreign Direct Investment in the United States: Detail for Position and Balance of Payments Flows, 1984, and subsequent articles for 1985, 1986, 1987, 1988, and 1989; Survey of Current Business, August 1985 and subsequent issues for August 1986, 1987, 1988, 1989, and 1990.

The five countries with the largest foreign direct investment positions in commercial real estate in 1989, accounting for 83.9 percent of the total, were Japan, the United Kingdom, Canada, the Netherlands, and the Netherlands Antilles. As shown in figure 2.1, in just a few years Japan has leapfrogged from having a relatively modest share of U.S. commercial real estate to having more than 2-1/2 times the share held by the United Kingdom. Japanese investors' holdings in the commercial real estate sector increased 64.3 percent in 1988 and 42.7 percent in 1989, so that in 1989 Japanese investors accounted for $14.3 billion, or almost 40 percent of the total. Thus, while other countries' investors also placed significant amounts of capital in the U.S. commercial real estate sector, the Japanese had by far the highest rate of increase. By 1987 Japanese investors also accounted for the greatest share of investment, not only when measured in terms of foreign direct investment position, but also in new enterprises acquired or established.

Figure 2.1: Five Countries With Largest Foreign Direct Investment Positions in U.S. Commercial Real Estate in 1989, as Compared to 1981



1989 - Total Foreign Direct Investment in U.S. Commercial Real Estate $35.85 Billion



1981 - Total Foreign Direct Investment in U.S. Commercial Real Estate $8.96 Billion

Source: BEA, Foreign Direct Investment in the United States: Detail for Position and Balance of Payments Flows, 1981 and 1989.

Nature and Extent of Foreign Commercial Property Holdings

BEA's new commercial property data provide information about foreign holdings of U.S. real property in all sectors of the economy, including real estate holdings by investors whose primary line of business is in another sector. These data give valuable new information about the nature and extent of foreign commercial property holdings and, for the first time, enable a reasonable estimate to be made of the portion of total U.S. commercial property that foreigners hold.

BEA reported in its 1988 Operations of U.S. Affiliates of Foreign Companies data series, published in August 1990, that a total of $100 billion in commercial property was held by U.S. affiliates of foreign companies in all industry sectors. Using Federal Reserve data on the value of all U.S. commercial property, BEA estimated that U.S. affiliates of foreign investors owned about 2 percent of U.S. commercial property in 1988. Canadian investors held by far the greatest share, followed by investors from Japan, the United Kingdom, and the Netherlands. The commercial real estate sector accounted for by far the largest share of foreign-held commercial property, followed by the services and retail trade sectors. Geographically, foreign investors placed the largest amount of their money in California, followed by New York and Texas.

Characterization of Foreign Investment in U.S. Real Estate

In general, foreign investment in U.S. real estate has flowed to the large metropolitan cities most familiar to foreign investors. It has been characterized by its concentration in high-value, high-profile, investment-grade properties, such as office buildings and hotels in premier locations in central business districts. As opportunities to purchase such properties in so-called "first-tier" cities (i.e., New York and Los Angeles) have diminished, investors have increasingly turned to second-tier cities (i.e., Atlanta and Phoenix) and from central business districts to suburban locations. This diversification has been due to investors' increasing familiarity with the U.S. market and desire for better returns as prices of premier properties have been bid up, decreasing investment yields.

The National Association of Realtors and the Massachusetts Institute of Technology's (MIT) Center for Real Estate Development conducted a joint study of foreign investment in U.S. real estate published in November 1988. The study examined foreign investments in the central business districts of six cities (Los Angeles; Washington, D.C.; Chicago; Phoenix; Atlanta; and Honolulu) over a 2-year period. It analyzed the nature and extent of foreign purchases of premier commercial properties in these major markets, as well as uncovered patterns of investment behavior.

The study found that foreign investors were a diverse group, with holdings in every major U.S. city. They had invested in literally every type of real estate product, including office buildings, shopping centers, regional malls, industrial properties, research and development centers, hotels, apartments, condominiums, single-family housing, and land. They had also entered into every phase of the real estate industry, including development, construction, brokerage, property management, construction financing, and permanent lending.

The study also identified certain patterns of investment behavior that were consistent across nationalities. These patterns included the following:

- Foreign investors tried to minimize the risks inherent in doing business abroad by investing in familiar products and by buying familiar businesses. They rarely invested in a product that they did not own back home.
- Investors new to the United States tended to buy in familiar cities, such as New York and Los Angeles, that had served as major ports of entry into the U.S. market. However, as foreign investors targeted preferred cities, they bid up the price of real estate, and attractive opportunities became increasingly scarce, forcing them to look to the secondary tier of cities.
- Some smaller foreign investors entered the United States seeking market niches where they did not have to compete for investment properties directly with larger, better capitalized foreign firms.
- As firms gained experience in the United States, they tended to undertake riskier transactions, such as redeveloping older properties or developing new properties because of the shortage of existing investment-grade properties.
- Foreign firms were becoming more aggressive in seeking out real estate investments, adapting their investment strategies to conform to local opportunities—for example, by investing in suburban locations where there was no dominant central business district.
- Foreigners were developing U.S. real estate businesses in addition to acquiring U.S. real estate assets. Not all foreign firms that had acquired U.S. real estate were passive investors. A number of companies had created subsidiaries to manage and market their investments.

High Concentrations of Foreign Real Estate Investment in Hawaii, California, and New York

We analyzed recent trends in foreign direct investment in U.S. commercial real estate in three states: Hawaii, California, and New York. Hawaii experienced a surge of foreign investment that was very high relative to the size of its real estate market. In addition, California and New York have consistently been among those states receiving the highest amounts of foreign investment in the commercial real estate sector.

Hawaii

The influx of foreign investment in the 1980s particularly affected Hawaii, which has a relatively small economic environment, and led to extensive media coverage. This investment generated significant public concern and controversy even though it directly involved only a relatively small part of the area's economic base. As a result, interested parties examined foreign direct investment in great detail. We have summarized some of this analysis in a case study in appendix II. It describes the extent of the influx of foreign investment and the conflicting views of government and private officials about its impacts.

We examined state, federal, and private sector data from 1959 through 1987 and estimated the extent of foreign investment in Hawaiian commercial real estate. This was a period of extensive foreign investment in Hawaii, which significantly affected the state's economy. We found that foreign individuals and corporations had invested at least $4.1 billion in commercial real estate in Hawaii through 1987. About 52 percent of these foreign investments occurred in 1986 and 1987, and the majority were in hotels and commercial office buildings. About $1.6 billion (70 percent) of the $2.3 billion invested in hotels and $490 million (38.1 percent) of the $1.3 billion invested in commercial office buildings from 1959 through 1987 was invested in 1986 and 1987.

Table 2.3: Total Foreign Investment in Hawaii Commercial Real Estate by Time Period and Type of Investment

Dollars in millions

	Time period			
Type	**1959-1985**	**1986-1987**	**Total**	**Percent in 1986-1987**
Hotels	$674	$1,582	**$2,256**	70.1
Commercial office buildings	796	490	**1,286**	38.1
Other lodgings[a]	498	94	**592**	15.9
Total	**$1,968**	**$2,166**	**$4,134**	**52.4**

[a]Includes condominium complexes and resort units not sold as separate residential dwellings.

Source: Hawaii Department of Business and Economic Development.

The federal and state agencies that tracked foreign investment in Hawaii primarily collected data on foreign purchases of individual properties and did not report the concentration (percentage of foreign ownership) within specific industries. However, we estimated the total percentage of foreign ownership of commercial properties by combining information from several state and private sources.

Foreign investors in the hotel industry owned 53 (26 percent) of the hotels in the state, accounting for 47 percent of the total hotel room inventory and 19 of the 25 highest-rated luxury hotels,[1] including the 5 most luxurious. Of the 19 luxury hotels, Japanese investors owned 16, Swiss investors owned 2, and an Australian firm owned 1.

Foreign individuals and corporations also owned the majority of the private golf clubs in Hawaii. According to state statistics and county officials, about 58 percent of the private golf clubs were foreign owned, including 10 of the 15 in Honolulu County, 4 of the 9 in Maui County, 3 of the 6 in Kauai County, and 5 of the 8 in Hawaii County.

BEA's commercial property data show that foreign investors owned a total of $3.53 billion in Hawaiian commercial property in 1988. Japanese affiliates were clearly the predominant foreign investors, accounting for $3.2 billion, or 90.1 percent of the total. The second largest share was held by affiliates of the United Kingdom, with $75 million, followed by affiliates of Australia, with $57 million.

Foreign investors in the services industry, which includes hotels, owned the largest share of Hawaiian commercial property in 1988, with $2.08 billion, or 58.8 percent, of the $3.53-billion total. The second largest share was in the commercial real estate industry, with $1.06 billion. Together, these two sectors accounted for 89 percent of the total.

California

Foreign investors concentrated most of their buying in the central business districts of Los Angeles and San Francisco, according to state and private sector reports. However, by 1988, with the number of premier properties for investment in the downtown areas declining, foreign investors were changing their investment strategies. Other areas in the state attracting foreign interest were San Diego, Orange County, Sacramento, and the southern portion of the San Francisco Bay area, although

[1]Rated "Four Diamond" or "Five Diamond," the highest ratings awarded by the American Automobile Association.

there were little authoritative data available on the magnitude of these investments. The California Department of Commerce did not have information broken down to the metropolitan area level.

BEA's commercial property data for California show that the value of foreign holdings in 1988 was $18.7 billion, or 18.7 percent of the nationwide total of foreign investment in U.S. commercial property. U.S. affiliates of Japanese companies had the largest share, with $5.4 billion (29.1 percent), followed by affiliates of Canada, with $3.9 billion (21.1 percent), and of the United Kingdom, with $2.5 billion (13.6 percent). The fourth largest share was held by U.S. affiliates of Kuwait, with $745 million.

Affiliates in the real estate sector owned the majority of foreign-held commercial property, with $11 billion (59.1 percent). The second largest share was held by affiliates in the services sector, with $2.1 billion (11 percent), followed by those in the wholesale trade sector, with $1.6 billion (8.4 percent).

New York

Foreign investors focused much of their real estate purchasing in New York City, buying numerous trophy properties. These purchases ranged from landmarks like the Rockefeller Center to prestigious Manhattan office addresses like the Citicorp headquarters building. An industry analyst reported that in New York City alone, between November 1986 and October 1987 Japanese investors bought the corporate headquarters of Exxon, Mobil, the American Broadcasting Company, and part of the Citicorp Center. They also bought prime office buildings such as Tower 49 and 666 Fifth Avenue, as well as landmarks such as the Tiffany and Company building and the Algonquin Hotel.

BEA's commercial property data show that foreign ownership of commercial property in New York State was valued at $15 billion, or 15 percent of such investments nationwide in 1988. The largest share was held by Canadian affiliates, with $4.4 billion (29.1 percent), followed by Japanese affiliates, with $3.9 billion (25.6 percent), together accounting for 54.7 percent. Ranking third and fourth, respectively, were affiliates of the United Kingdom, with $1.4 billion, and affiliates of Kuwait, with $1 billion. By far the largest share was invested in the commercial real estate sector, with $10.2 billion (67.9 percent). The next largest share was in the services sector, with $1.6 billion (10.5 percent).

Recent Market Downturn Slows Foreign Real Estate Investments

In late 1989 the U.S. commercial real estate market experienced a serious downturn. This decline also curbed foreign investments, according to industry experts. The reasons for the downturn involve factors that are both internal and external to the U.S. market. Some of the internal forces that led to the current market decline include the following:

- The U.S. commercial real estate market was overbuilt. This overbuilding has caused high vacancy rates and depressed rents, thus reducing the return on investment.
- Trophy or investment-grade properties were overpriced. Competition for these properties has kept prices high, caused return on investment to decrease, and discouraged further investment.
- Japanese investment has decreased because of growing U.S. public hostility. The Japanese are sensitive to perceptions of American antagonism. This hostility has caused Japanese investors largely to refrain from participating in purchases of landmark or nationally important properties, especially after the public outcry over a Japanese firm's purchase of the Rockefeller Center. Industry analysts believe that fear of a public protest restrained the Japanese from bidding on the purchase of the Sears Tower in Chicago.
- Domestic capital available for real estate investments diminished due to the savings and loan crisis. Although U.S. pension funds and other institutional investors, such as life insurance companies, are still active in the market, their investment criteria generally favor higher-value, low-risk projects.

Among the factors external to the domestic market that have affected the current U.S. commercial property market decline are the following:

- Japanese investors have experienced lower liquidity due to economic circumstances in Japan, where interest rates have increased and the stock market has fallen. Thus, Japanese access to low-cost capital has decreased. At the same time, there are more investment opportunities at home, with the rate on the Japanese government 10-year bond having increased from 5 percent in autumn 1989 to around 7.5 percent by December 1989, the highest rate since 1984, and then up to 8 percent by summer 1990.
- Investment opportunities in Western Europe have become more attractive in anticipation of the European Community's single market in 1992. According to industry analysts, these opportunities have caused some shift in foreign direct investment from the United States to the European Community.

- East-West tensions have diminished. This factor, which should not be overstated, is considered noteworthy by some analysts. As Eastern Europe and the Soviet Union continue the process of rapprochement with the West, placing money in the United States as a "safe haven" is becoming less important. However, analysts stress that political stability is very important to investors and that there is still a great deal of political turmoil in Eastern Europe; this turmoil continues to make investment in the United States attractive. Furthermore, the recent crisis in the Middle East has likely reaffirmed the value of the United States as a safe haven for investments.

Concerns About Foreign Direct Investment in U.S. Real Estate

Although foreign direct investment during the 1980s flowed into all sectors of the U.S. economy, investments in real estate attracted particular public attention because of their high visibility and the press attention given to their sales. When foreign investors bought landmarks such as the Exxon Building in New York, the IBM Building in Atlanta, the Arco Plaza in Los Angeles, and most of the ocean-front hotels along Waikiki Beach in Honolulu, these purchases were very conspicuous.

The primary public concern about foreign purchases of U.S. real estate appeared centered on an emotional reaction to the "selling of America." One example of this emotional backlash was the reaction to the sale of the Rockefeller Center, considered by many as a cultural landmark, to Mitsubishi Estate Company of Tokyo, when it purchased 51 percent of the Rockefeller Group, Inc. The Rockefeller Group stated that too much of its portfolio was in real estate holdings and that it wanted to diversify. When the press reported that a foreign interest had purchased the Rockefeller Center, however, there was a public outcry against allowing a major American landmark to pass into foreign control.

Industry experts, nevertheless, went beyond purely emotional reactions and focused on more specific concerns. We found that there were two major concerns about foreign investment in U.S. commercial real estate. The first concern was that a surge in property purchases by foreigners, especially where these led to high concentrations within a narrow market segment for investment-grade properties, would result in excessive real estate price increases. The second concern involved increasing foreign competition for market share in the commercial real estate development and construction industry, especially where foreign investors were perceived to have financial advantages over U.S. investors.

Regionally, these concerns were echoed and amplified, depending on the level and kinds of investments predominant in a specific market. However, the state and local officials we talked to in California and New York, as well as the industry analysts we contacted, generally stated that there was no real need for concern. In Hawaii, which has experienced a relatively high level of foreign investments, state and local officials expressed the most concern.

Concerns Related to Investment in Real Property

Much of the concern expressed about foreign direct investment in real estate was focused on high concentrations of foreign investments within a narrow, high-value market segment for investment-grade properties. Such concentrations generally increase demand beyond available supply and cause the prices of similar properties to rise, which is known as the "price effect." These high concentrations of foreign investment could also increase the tax assessment of surrounding properties. A related concern was that the price effect of concentrated foreign investments in residential real estate markets could further reduce housing affordability for Americans in these already high-priced markets.

Concentration and Price Effects in Commercial Real Estate Markets

Foreign investors' real estate purchases focused on investment-grade office buildings and hotels, generally in downtown locations in major cities, as well as on a few regional shopping centers and resorts in prime locations. These purchases concentrated foreign investments within a narrow market segment, causing a much greater impact upon the relatively few markets containing such properties than the total size of foreign purchases would indicate. As a result, prices reportedly increased in these so-called "first-tier" markets, particularly in a few of the largest cities on the East and West Coasts, such as New York; Washington, D.C.; and Los Angeles, as well as in Hawaii.

With the greatly enhanced buying power of the yen versus the dollar after 1985,[1] the easing of Japanese government restrictions on the outflow of capital after 1980, and the longer-term expectation used in calculating return on real estate investments, Japanese investors paid record prices for buildings they expected to own and operate well into the next century. According to press reports, Mitsui Fudosan, the U.S. affiliate of Japan's largest property development company, paid $610 million for the Exxon Building in December 1986, a record for a single New York address. In September 1986, Shuwa Corporation, another large Japanese developer, paid a record $365 per square foot (or an estimated $165 million to $185 million) for the American Broadcasting Company's headquarters on the Avenue of the Americas. Then Dai-Ichi Real Estate, the U.S. affiliate of Dai-Ichi Mutual Life Insurance Company, Japan's second largest insurer, set what was expected to remain the new price-per-square-foot record for some time to come when it paid $94 million, or nearly $1,000 per square foot, for the Tiffany and Company building in November 1986.

[1] The yen appreciated by 85 percent against the dollar between September 1985 and February 1988, going from around 240 yen to the dollar to around 130 yen to the dollar.

This flood of real estate investments, mainly by Japanese investors, was also apparent in Los Angeles. There, for example, Sumitomo Life Insurance Company bought 1000 Wilshire Boulevard for $145 million in January 1986. Then, in September 1986, Shuwa Corporation set a record for a Los Angeles office property when it bought the Arco Plaza complex for $620 million.

The Japanese have been the leading foreign players in the commercial real estate market since 1985. Although Canadian, British, and Dutch investors, as well as others, also invested in U.S. commercial real estate during this time, American concern was generally directed toward Japanese purchases. One reason might have been that Canadian and European investors had been buying commercial properties for a long time and were familiar players, while the Japanese investors were relative newcomers. They had also made a spectacular entrance into the market, with a large volume of high-value purchases, many at what were perceived to be above-market prices.

The impact of high concentrations of foreign real estate investments and their resulting price effects is difficult to assess because it includes costs and benefits that accrue to different parties. Some of the costs are, first, that a high concentration of foreign investments may bid up prices, causing some domestic investors (i.e., buyers) to be priced out of the first-tier market. As purchase prices increase, properties may become prohibitively expensive or the return on investment may decline so much as to make such investments unattractive. Second, as prices increase, so do tax assessments. Third, the surge of foreign investments is also believed to have further contributed to overbuilding in the commercial real estate market.

On the other hand, some of the benefits are, first, that property owners gain from the appreciated value of their holdings, and sellers of these properties receive higher profits. Second, these additional profits could potentially further increase the pool of available real estate investment capital, if they are reinvested. Third, local governments receive greater tax revenues, and, fourth, renters may receive lower rental costs to the extent that additional overbuilding results in higher vacancy rates.

In the aggregate, industry experts generally consider foreign investment beneficial as a source of stable, long-term capital. Their reasons for believing that foreign investment in U.S. real estate is advantageous are the following:

- Investment in real estate does not involve any national security interests. There is no transfer of high-technology products or processes involved.
- Investment in real estate is illiquid: Foreign owners cannot easily and quickly dispose of property. Therefore, these investments are relatively stable. In contrast to stocks, for instance, the foreign owner cannot simply call in an order to sell and expect to have the transaction completed that day.
- The inflow of foreign capital may actually have helped to enhance the value and attractiveness of the U.S. commercial property market by providing needed liquidity.

Industry analysts also stress that the U.S. real estate market is far too large and deep to be endangered by outside control. For example, we were told that every year far more new real estate properties are added to the market through new construction than are sold to foreign purchasers. The sheer size of the U.S. real estate market protects it from being overwhelmed by foreign investors.

Concerns About Concentration and Price Effects on Residential Real Estate Markets

A related concern about the price effects of a high concentration of foreign real estate investments was also particularly strong in residential real estate markets. For example, in Hawaii, foreign investments in residential real estate, even more so than in commercial real estate, provided what some believed to be a clear example of how high market concentrations raised prices and property taxes. In addition, there was concern that foreign investments had further reduced the affordability of housing in the state. Views differed, however, on the degree to which foreign investments could be directly linked to increased property prices and taxes, as well as to decreased housing affordability. Generally, state and county officials believed that there was a strong causal linkage, while federal and some private sector officials felt that foreign investments were only one factor of many causing higher prices.

State and local government and private officials in Hawaii generally concluded that foreign investors raised prices and property taxes in certain Oahu[2] neighborhoods where they made purchases. According to the Honolulu County Finance Department, property values were estimated to have increased an average of 40 percent from 1987 to 1988 in the prestigious area of Kahala, based on the county's 1989 assessments. The Waikiki tourist area was expected to experience a 30-percent increase

[2]Honolulu County consists of the island of Oahu.

over the same period. A real estate company analysis showed that Japanese investors bought about 27 percent of the homes sold in Kahala and over 41 percent of the condominiums sold in Waikiki in 1987. In addition, a University of Hawaii Real Estate Center study found that Japanese buyers raised prices in the Kahala neighborhood by paying approximately 20 percent more than other buyers for the average-sized residential property in the area.[3]

According to some state and county officials, foreign investment raised the prices of residential property throughout Oahu, as well as in the specific neighborhoods mentioned above. According to a second University of Hawaii study,[4] Oahu housing prices increased an average of 36 percent in 1987.[5] State and local officials said that foreign investors contributed to this price inflation in two ways. First, foreign investors were willing to pay above-market prices for property, encouraging sellers to raise their asking prices. Second, local residents who sold property to foreign investors used their profits to buy properties in other neighborhoods, raising prices in these areas as well.

A related concern was that higher real estate prices could also decrease housing affordability in Hawaii, according to state and county officials. The February 1989 University of Hawaii study found that only 15 of Oahu's 97 neighborhoods were generally affordable to middle-class purchasers in 1988. A 1989 position paper from the Governor's Office of State Planning stated that foreign investor purchases might have increased the prices of some properties above local residents' ability to pay. Additionally, the Mayor of Honolulu County said that, because Oahu already had high average home prices, further residential real estate price increases would reduce local residents' opportunities to purchase homes.

[3] Japanese Purchases, Exchange Rates and Speculation in Residential Real Estate Markets, (Honolulu: University of Hawaii, Hawaii Real Estate Center, Mar. 1988).

[4] A Study of Foreign Investment in Real Property and Its Impact on the State: A Taxonomy of Possible Options for Legislative Consideration, (Honolulu: University of Hawaii, Hawaii Real Estate Center, Feb. 7, 1989).

[5] The median price for a single-family home on Oahu has increased dramatically since that time. According to the Honolulu Board of Realtors, the median price was $185,000 in 1987. As of July 1990 it was $363,000, up 41 percent from just a year earlier. In addition, Honolulu's single-family median price was $345,000, ranking the city first nationally among 98 metropolitan areas, up 33 percent from a year earlier. The median price is the level at which there are equal numbers of prices above and below that level.

However, there were some conflicting views on the causes of Oahu residential property price increases. While some state and county officials believed that foreign investors raised prices for all residential property on Oahu, other government and private officials attributed these price increases on Oahu to other factors. According to federal and private officials, foreign investors purchased too few properties to affect prices islandwide. Foreign investors owned about 1 percent of the total Oahu housing stock as of October 1988. Even in the Kahala neighborhood, where 35 percent of the foreign single-family home purchases occurred, foreign investors bought less than 3 percent of the homes. Instead, these officials believed that real estate prices rose because the demand for housing exceeded supply. According to a study by the MIT Center for Real Estate Development,[6] housing construction had not kept pace with increases in the population. The officials also believed that the state's natural real estate market cycles exacerbated recent islandwide increases.

Officials also had differing opinions on the impact of foreign investor purchases on the supply of housing. According to the Governor's Office of State Planning, foreign purchases of Hawaiian residential properties for vacation homes and rentals reduced the supply of housing for local residents. Other state officials said that foreign investors diminished the housing supply by buying units and then leaving them vacant. However, real estate officials believed that most foreign investors purchased Hawaiian properties as investments and would therefore want to rent the units. Another real estate expert believed that the majority of the residential properties foreign investors bought were investor-owned units, so the purchases amounted only to changes of ownership, and few local tenants were displaced.

Concerns about the impact of high concentrations of foreign real estate investments and resulting price effects in Hawaii residential real estate highlight another important point: It is very difficult to establish a direct causal linkage between foreign investment inflows and the perceived effects on the real estate market. Although foreign investments may significantly contribute to housing shortages and price increases, they are not the only factor involved.

[6]Lawrence S. Bacow, "The Internationalization of the U.S. Real Estate Industry," WP #16, (Boston: MIT Center for Real Estate Development, Nov. 1988).

Concerns Related to Investment in Real Estate Businesses

A second set of concerns related to the effects of increasing foreign participation in the commercial real estate industry itself, especially where foreign investors were believed to have financial advantages.

Increasing Foreign Presence in Commercial Real Estate Industry

Many of the foreign investors in the U.S. real estate market were foreign real estate development and construction companies that were interested not only in real estate investments, but also in gaining American market share in the increasingly international real estate industry. For a European, Canadian, or Asian development or construction company, gaining market share in the United States was desirable because the United States has the world's largest supply of investment-grade real estate. It also offers a wide array of investment options and structures and is often viewed as a good place to take a first step in any international expansion.

According to some industry experts, the Japanese in particular were determined to establish a major presence in the U.S. real estate industry and could be expected to get deeply involved in the ownership, operation, leasing, development, and construction of property in America. One way Japanese contractors had initially entered the market was by winning the construction contracts for Japanese manufacturing facilities in the United States, which gave them entry, experience, profits, and a U.S. track record. Once the contract had been won, Japanese companies could use a strategy of setting up different departments, such as general construction, engineering, and construction and development, so that they could eventually establish vertically integrated subsidiary firms.

During the late 1980s, distinctions were blurring between institutional investors, developers, and commercial tenants as each tried to control its risk. The number of investment-grade properties available for investment at a desirable rate of return had decreased due to market saturation, according to industry analysts. This decrease left many investors with the choice of the most expensive buildings or the emptiest, which meant having a reduced return on investment and undertaking greater risk. Many were looking beyond the "trophy" buildings that represented the safest bets and were becoming developers or financiers to get better returns. Some large tenants were entering joint ventures with developers and providing investment capital in order to obtain more favorable rental terms.

Concerns about increased foreign competition in the real estate industry were often overstated, however, according to some industry analysts. They believed that those in the industry generally welcomed foreign investment capital. U.S. developers, in particular, were able to undertake projects because of access to foreign capital through joint ventures. An MIT Center for Real Estate Development study stated that because real estate is such a local industry, there was no comparative advantage that could accrue to foreign firms: "Notwithstanding the internationalization of capital markets, development, marketing, and management of real estate are local activities that require knowledge of local tastes, local politics, and local practices."[7]

Cost of Capital Advantage for Japanese Competitors

Beyond the normal fears associated with new competition in the U.S. market, there was serious concern about the close ties that Japanese firms had to Japanese banks. These ties were believed to have provided Japanese competitors with two important advantages: (1) easier access to capital and (2) lower cost of capital.

Until recently, a top Japanese developer could borrow dollars from its Japanese lead banks on the strength of its corporate credit and at a rate far lower than the conventional lending rate a U.S. borrower would pay. This difference in borrowing costs on a building could often make the difference between a positive and a negative cash flow for a developer. Similarly, Japanese contractors also had close ties to Japanese banks and could pledge their corporate credit to obtain construction loans at lower costs than an American contractor could get from an American bank.

One reason for this situation was that Japanese banks lend capital to Japanese companies on the strength of the companies' corporate credit and cash flow. The Canadians have similar lending procedures, in which they look at the balance sheet of the borrowing company. In contrast, the American practice is for lenders to provide real estate capital on a project-by-project basis, making the lending decision and terms based on the lenders' assessment of the strength of the project rather than on the strength of the borrower. Such loans are made on a nonrecourse basis for the borrower, so that the project itself, not the borrower's own assets, is collateral for the debt.

[7]Lawrence S. Bacow, p. 12.

The second advantage Japanese competitors were perceived to have until recently is the much lower cost of capital. The Japanese official discount rate, the rate charged on loans by the central bank to the large money center commercial banks, fell to 2.5 percent in 1987 and stayed at that level until May 1989, when it increased to 3.25 percent. During this period, these low rates encouraged massive business investment, including foreign direct investments in U.S. real estate and increased market entry by Japanese real estate firms.

However, the Japanese official discount rate has risen significantly in recent months. It increased to 4.25 percent in December 1989 and to 6 percent in August 1990, where it has remained. The official U.S. discount rate, which had ranged from 6 percent to 7 percent while the Japanese rate was 2.5 percent, remained steady at 7 percent from March 1989 through November 1990 and then fell to 6 percent in February 1991 (the latest date for which comparative information was available). Thus, in February 1991, for the first time since 1976, the U.S. discount rate was no longer higher than that of Japan.

Regional Concerns in Hawaii, California, and New York

The above concerns were also reflected regionally, depending on the level and type of investments predominant in that market area. In Hawaii, which had experienced a relatively high level of foreign investment, state and local officials expressed the greatest anxiety. However, outside Hawaii, most state and local officials we talked to, as well as the industry analysts we contacted, generally stated that there was no real cause for concern about foreign investment in real estate.

Hawaii

Concerns in Hawaii about the effects of foreign investment in the real estate industry were related to the strain on the state's infrastructure, the potential to alter the unique character of the islands, and the effects of increased golf course development.

While foreign investors minimized the effect of some development by installing public water lines, widening roads, and constructing a refuse collection station, other effects were causing infrastructure problems. According to the Director of the Kauai County Public Works Department, the impact fees the county assessed developers had not adequately compensated the county for the increased use of county roads, water and sewer systems, and beach parks resulting from new hotel development. Another county official stated that Kauai was beginning to experience waste treatment and water supply problems because of

new development on the island. On Maui, two foreign resorts were denied occupancy permits until the county could build a highway bypass to relieve the traffic problems created by the hotels. Golf course developments were also a problem for the state because of their water requirements. According to the Honolulu County Department of Water Supply, a 150-acre golf course requires about 600,000 gallons of water per day. In contrast, a 600-unit housing development on 150 acres would require only 300,000 gallons of water per day. Additionally, government and private officials were aware of at least four instances in which tenants were displaced or threatened with eviction as a result of golf course developments by foreign investors.

In addition to straining the infrastructure, hotel development could alter the unique character of the islands, as some county and private officials pointed out. According to one county official, local residents had to adjust to the increased number of visitors and the ensuing traffic and crowds. One local real estate expert also noted that the new hotels being built might lead to overdevelopment of some islands and, thus, reduce Hawaii's uniqueness as a tourist destination because the new hotels might be too similar to other resorts worldwide. On Kauai, the construction of one hotel was halted by voter initiative in 1980 because of concerns over restricted public access to the shoreline. According to state and local officials, population growth resulting from hotel developments also increased competition for housing on Kauai. In another instance, construction of a foreign-owned hotel on Maui required the disinterment and reburial of Native Hawaiian remains discovered on the hotel site.

California

In California, state and local government officials were not worried about foreign direct investment. In fact, the state government and many local governments were actively pursuing such investment. The Director of California's Department of Commerce said that the state was interested in investment that creates jobs. In 1986 California decided to vigorously promote foreign investment by establishing overseas offices. Foreign direct investment was perceived as a boon for the local economy and a way to reduce the trade deficit while providing little threat to state and national sovereignty.

One factor important to public perceptions about foreign investment in real estate was that California commercial properties had been overbuilt in the last few years. According to the Bank of America, commercial real estate construction peaked in 1986 and was followed by record vacancy

rates, concessionary rents, and sluggish construction levels. Several factors helped to revive commercial building in 1988; one of them was the strong foreign investment in the state. This overbuilt condition also reduced the concern over the chance that foreign investments might escalate the cost of properties.

Two private sector executives noted that foreign investment in the Los Angeles residential real estate market also was not a matter for concern. The President of the Los Angeles Board of Realtors, as well as an official of the accounting firm of Kenneth Leventhal and Company, said that the city's residential real estate problems had not been caused by foreign purchases.

New York

According to a July 1988 publication by the Congressional Economic Leadership Institute, foreigners owned over 20 percent of the commercial property in midtown Manhattan. Although there had been numerous press accounts expressing public concern about the effects of foreign investments in New York real estate, state and local officials felt little concern was justified. An official of the Real Estate Board of New York, Inc., stated that the Board was not troubled about the extent or type of foreign direct investment in Manhattan real estate. He believed that such investments were part of New York's historical role as a port of entry for foreigners.

Both this official and a real estate analyst from a major investment house said that the concern over foreign investment in real estate was overblown. They believed that foreign investors, particularly the Japanese, at one time had paid higher than necessary prices to acquire prime office buildings with already occupied, leased space. This overpayment had driven up rents and purchase prices but had benefited sellers as well as municipalities that had collected increased revenues in the form of higher property taxes.

Conclusions

Upon review of the concerns about foreign direct investment in U.S. real estate and after discussions with industry analysts, we found that foreign direct investment in the real estate sector should not be a matter of serious national concern. In fact, industry experts generally consider such investment beneficial as a source of stable, long-term capital. They point out that foreign investment in U.S. real estate does not involve any national security interests or transfer of high-technology products or processes. Such investments are also illiquid and, therefore, relatively

stable. Finally, they may even have helped to enhance the value and attractiveness of the U.S. commercial property market.

The sheer size of the U.S. real estate market protects it from being overwhelmed by foreign investors. Every year, far more new real estate properties are added to the market through new construction than are sold to foreign purchasers. Industry analysts stress that the U.S. real estate market is far too large and deep to be endangered by outside control. The BEA estimated that foreign direct investors owned only about 2 percent of the total stock of U.S. commercial property in 1988. Thus, the consensus among industry analysts is that foreign direct investment in U.S. real estate does not merit serious national concern.

While foreign direct investment in the aggregate may be beneficial to the real estate market, there are particular concerns at the state and local level in those areas where investments have been concentrated. We found, however, that the impact of capital inflows into the real estate market was difficult to assess because these investments affected the individual players in that market in different ways—benefiting some and hurting others. We also found that there were conflicting views on the causes of impacts and that a direct causal linkage between foreign inflows and the effects on the real estate market as perceived by the general public had not been established.

Data on Foreign Direct Investment in U.S. Real Estate

Distinctions Between Real Estate and Commercial Property Data

The Commerce Department's Bureau of Economic Analysis (BEA) collects detailed statistical information on foreign direct investment in the United States through four data series that capture different aspects of the total investment picture. We have examined these data series in previous GAO reports.[1]

BEA provides the data pertinent to foreign real estate holdings by separating out (1) the commercial real estate sector and (2) commercial property ownership across all industry sectors. The real estate sector data include ownership of real estate businesses, as well as property.[2] The commercial property data include property ownership across all sectors of the economy, whether in the real estate sector or the manufacturing or services sectors. This distinction has occurred because BEA established a new category for commercial property data under its grouping for "gross book value for property, plant, and equipment" in its Foreign Direct Investment in the United States: 1987 Benchmark Survey, which was published in August 1989. Previously, BEA had only collected data for the real estate industry sector. Table I.1 shows the relationship between these two kinds of data.

Table I.1: Selected Data of U.S. Affiliates of Foreign Companies by Industry of Affiliate, 1988

Dollars in millions

		Gross property, plant, and equipment		
Industry sector	**Total assets**	**Total**	**Commercial property**	**Other**
All industries	$1,147,237	**$406,172**	$100,020	$306,152
Petroleum	85,388	**93,479**	5,150	88,329
Manufacturing	281,316	**154,095**	9,074	145,021
Wholesale trade	111,922	**24,275**	6,182	18,092
Retail trade	39,230	**18,742**	10,289	8,453
Finance, except banking	335,794	**4,499**	1,036	3,464
Insurance	139,500	**4,179**	2,727	1,452
Real estate	73,643	**57,731**	50,146	7,584
Services	42,201	**16,948**	10,957	5,991
Other industries	38,244	**32,225**	4,458	27,767

Source: BEA, Foreign Direct Investment in the United States, Operations of U.S. Affiliates of Foreign Companies, 1988, tables 9 and D-10.

[1]For detailed information, see Foreign Investment: Federal Data Collection on Foreign Investment in the United States (GAO/NSIAD-90-25BR, Oct. 3, 1989) and Foreign Investment: Trends in Foreign Ownership of U.S. Farmland and Commercial Real Estate (GAO/NSIAD-89-168FS, July 10, 1989).

[2]BEA's industry classification for the real estate sector is "Buying, selling, developing, owning, and leasing real property by real estate operators, lessors, developers, subdividers, agents, brokers, and managers. Owners and lessors of real estate used for agricultural or timber growing purposes that the owners or lessors do not operate themselves but lease to others. Real estate investment trusts."

Because BEA classifies investments according to the primary industrial classification code or line of business of the firm, real estate owned by firms classified in other sectors is included with the other asset holdings of that sector and does not show up under the real estate sector. Due to this methodological limitation, serious undercounting of foreign ownership of real property occurred. This undercounting was redressed to some extent by breaking out an additional category for commercial property under the category of "gross book value of property, plant, and equipment," information provided by all industry sectors. Specifically, BEA defines commercial property as "the gross book value of all commercial buildings and associated land owned by the affiliate that is either used or operated by the affiliate or leased or rented to others."[3]

Thus, these two data sets are designed to capture different measures of "real estate." The new commercial property data focus on property ownership, regardless of the industry sector involved. These data would include, for example, the corporate headquarters of a foreign oil company (whose assets are otherwise listed under the petroleum sector), land owned by a foreign auto company (manufacturing sector), or foreign-owned hotels (services sector). In contrast, the existing real estate sector data focus on ownership of commercial real estate businesses, such as real estate brokerage houses, as well as ownership of commercial real estate assets, such as office buildings and land, by investors whose primary line of business is real estate.

BEA's Commercial Property Data

In 1988 there were 14 countries whose investors owned more than $1 billion in U.S. commercial property. Of these, four countries accounted for $63 billion, or 63 percent, of the $100 billion total. These countries were Canada, with $23.9 billion; Japan, with $16.8 billion; the United Kingdom, with $15 billion; and the Netherlands, with $7.3 billion. Table I.2 shows the value of commercial property holdings by country.

[3]According to the BEA, "commercial buildings include apartment buildings, office buildings, hotels, motels, and buildings used for wholesale, retail, and services trades (such as shopping centers, recreational facilities, department stores, bank buildings, restaurants, public garages, and automobile service stations)."

Table I.2: U.S. Commercial Property Owned by Foreign Affiliates—by Country of Ultimate Beneficial Owner (1987-1988)

Dollars in millions

Country	Commercial property value	
	1987	**1988**
All countries[a]	$89,919	$100,020
Canada	22,509	23,894
Europe, total	35,339	39,247
Belgium	1,437	1,370
France	3,477	3,656
Germany	4,734	4,863
Netherlands	6,556	7,326
Sweden	424	1,658
Switzerland	2,909	3,105
United Kingdom	13,315	14,978
Latin America and other Western Hemisphere	3,385	3,649
Netherlands Antilles	964	1,045
Africa	381	379
Middle East	8,197	9,221
Kuwait	4,538	4,491
Saudi Arabia	2,289	3,372
United Arab Emirates	1,001	985
Asia and Pacific, total	19,596	22,561
Australia	2,101	2,567
Hong Kong	1,438	1,371
Japan	14,096	16,769
United States[b]	512	1,070
Addenda[c]		
European Communities (12)	31,296	33,668
OPEC	8,072	9,144

[a]Subtotals may not add up to total for all countries due to rounding.

[b]The United States is listed here because it is the country of the ultimate beneficial owner for investments for which there are intermediary foreign parents.

[c]These are memoranda entries and should not be included in adding together individual items to reach a total for all countries.

Sources: BEA, Foreign Direct Investment in the United States, Operations of U.S. Affiliates of Foreign Companies, Preliminary 1988 Estimates, August 1990, table D-11; Foreign Direct Investment in the United States: 1987 Benchmark Survey, Final Results, August 1990, table D-11.

The value of foreign-held commercial property across all major sectors of the economy can be seen in table I.3. The largest foreign investment by far was in the real estate sector, which had $50.1 billion, or 50.1 percent, of the total. The second largest sector was the services sector, with 11 percent, closely followed by retail trade, with 10.3 percent. Hotels,

which are classified under services, registered $6 billion in foreign commercial property holdings.

Table I.3: U.S. Commercial Property Owned by Foreign Affiliates—by Industry of Affiliate (1987-1988)

Dollars in millions

	Commercial property value	
Industry	**1987**	**1988**
All industries[a]	$89,919	$100,020
Petroleum	3,138	5,150
Manufacturing, total	7,683	9,074
Food and kindred products	1,264	909
Chemicals and allied products	2,316	2,439
Primary and fabricated metals	421	904
Machinery	1,104	979
Other manufacturing	2,578	3,843
Wholesale trade	5,850	6,182
Motor vehicles and equipment	2,039	1,963
Retail trade	7,578	10,289
General merchandise stores	[b]	5,185
Food stores	2,382	2,644
Finance, except banking	936	1,036
Insurance	2,406	2,727
Real estate	49,760	50,146
Services	8,570	10,957
Hotels	5,032	6,024
Other industries	3,999	4,458
Agriculture, forestry, and fishing	1,214	1,243
Transportation	1,328	1,731
Communication and public utilities	1,014	1,055

[a]Subtotals may not add up to total for all industries due to rounding.

[b]Data in the cell have been suppressed by BEA to avoid disclosure of data of individual companies.

Sources: BEA, Foreign Direct Investment in the United States, Operations of U.S. Affiliates of Foreign Companies, Preliminary 1988 Estimates, August 1990, table D-10; Foreign Direct Investment in the United States: 1987 Benchmark Survey, Final Results, August 1990, table D-10.

Foreign-held commercial property was concentrated in three states (see table I.4). California had the largest share, with $18.7 billion (18.7 percent); followed by New York, with $15 billion (15 percent); and Texas, with $9.7 billion (9.7 percent). Regional concentrations somewhat reflected the state-level distribution. The Mideast region, which includes New York, had the largest share of foreign investment, with 24.65 percent; and the Far West, which includes California, had the second largest

share, with 21 percent. The Southeast had the third largest share, with 18.4 percent. Commercial property holdings in Florida and Georgia were an important factor in that region. The Southwest, which includes Texas, was fourth, with 12.2 percent.

Table I.4: U.S. Commercial Property Owned by Foreign Affiliates—by State (1988)

Dollars in millions

	Commercial property value	
U.S. regions and states	**1987**	**1988**
New England		
Connecticut	$1,216	$1,467
Maine	305	371
Massachusetts	2,476	2,361
New Hampshire	245	264
Rhode Island	123	127
Vermont	42	39
Mideast		
Delaware	505	523
District of Columbia	1,533	1,682
Maryland	1,221	1,265
New Jersey	3,130	3,555
New York	13,292	15,039
Pennsylvania	2,054	2,595
Great Lakes		
Illinois	3,674	4,451
Indiana	502	848
Michigan	932	933
Ohio	1,925	2,788
Wisconsin	443	534
Plains		
Iowa	254	281
Kansas	204	214
Minnesota	1,241	1,418
Missouri	824	924
Nebraska	99	93
North Dakota	62	25
South Dakota	[a]	34
Southeast		
Alabama	163	340
Arkansas	252	327
Florida	5,105	6,000

(continued)

U.S. regions and states	Commercial property value	
	1987	1988
Georgia	3,092	3,552
Kentucky	641	754
Louisiana	1,320	1,416
Mississippi	191	200
North Carolina	1,509	1,659
South Carolina	732	799
Tennessee	780	1,056
Virginia	2,029	2,169
West Virginia	78	90
Southwest		
Arizona	1,432	1,615
New Mexico	210	295
Oklahoma	676	621
Texas	9,736	9,677
Rocky Mountains		
Colorado	1,971	2,121
Idaho	33	32
Montana	92	73
Utah	147	139
Wyoming	35	22
Far West		
California	17,848	18,687
Nevada	441	488
Oregon	581	542
Washington	1,153	1,304
Alaska	[a]	252
Hawaii	2,848	3,528
Puerto Rico	43	97
Other U.S. areas[b]	202	175
Foreign[c]	33	159

[a]Indicates that data in the cell have been suppressed by BEA to avoid disclosure of data of individual companies.

[b]Consists of the Virgin Islands, Guam, American Samoa, U.S. offshore oil and gas sites, and all other outlying U.S. areas.

[c]Consists primarily of movable fixed assets temporarily located outside the United States and of any foreign assets, including mineral rights carried on the U.S. affiliates' books.

Sources: BEA, Foreign Direct Investment in the United States: Operations of U.S. Affiliates of Foreign Companies, Preliminary 1988 Estimates, August 1990, table D-12; Foreign Direct Investment in the United States: 1987 Benchmark Survey, Final Results, August 1990, table D-12.

Foreign Direct Investment in Hawaii: A Case Study

We estimate that foreign individuals and corporations invested at least $5.4 billion in Hawaii between 1959 and March 1988. The majority of this investment, $4.68 billion, was in businesses and commercial property; the next largest investment category was residential real estate, at $637 million, followed by agricultural land, at about $60 million. Most of the investment in businesses and commercial property, $2.34 billion, occurred in 1986 and 1987 and was made by Japanese investors. We used the most reliable data available in making our estimates.[1]

Businesses and Commercial Property

Foreign individuals and corporations have invested at least $4.68 billion in businesses and commercial property in Hawaii. About $3.7 billion (80 percent) of the total investment from 1959 through 1987 was made by Japanese investors. Other countries (including Hong Kong, the United Kingdom, Australia, and Canada) each had investments of 5 percent of the total, or less. About 50 percent of these investments were made in 1986 and 1987, and the majority were in hotels and commercial office buildings. About $1.6 billion (70 percent) of the $2.3 billion invested in hotels and $490 million (38.1 percent) of the $1.3 billion invested in commercial office buildings was invested in 1986 and 1987.

The federal and state agencies that tracked foreign investment in Hawaii primarily collected data on foreign purchases of individual businesses and did not report the concentration (percentage of foreign ownership) within specific industries. However, we estimated the total percentage of foreign ownership of the largest companies in Hawaii and selected businesses and commercial properties by combining information from several state and private sources. Foreign investment in the hotel industry and in private golf clubs was discussed in chapter 2.

Foreign individuals and corporations had also invested in the retail, insurance, and banking industries in Hawaii. For example, in retailing, three of the seven largest department stores in Hawaii were owned by foreign corporations. These three stores accounted for about 38.6 percent of the sales of the largest seven stores in 1987. In addition, foreign investors had partial ownership positions in 5 of the 20 insurance firms headquartered in Hawaii, according to the Hawaii Insurance Commissioner. These 20 firms represented 2.6 percent of the 782 insurance

[1] We used available federal and state agency data, special studies, and interviews with knowledgeable public and private sector officials to compile our estimates of foreign direct investment in Hawaiian businesses and commercial property, residential real estate, and agricultural land.

firms licensed in the state and accounted for 7.7 percent of the $2.9 billion invested by these firms. Foreign investors also had ownership positions in two of the seven banks chartered by the state, with one bank owned by an investor from Indonesia and 13 percent of the stock of the other bank held by a Japanese bank. These two banks had a total of $705 million in assets, or 6.7 percent of Hawaiian banks' total assets.

Residential Real Estate

Foreign individuals and corporations, mainly from Japan, purchased 2,065 single-family homes and condominiums for $637 million on Oahu from January 1987 through March 1988. Foreign purchases accounted for about 4 percent of residential sales and 13 percent of condominium sales on Oahu during 1987. Foreign investor purchases were concentrated in a few select neighborhoods and resort areas. Foreign buyers usually purchased higher priced homes but more moderately priced condominiums.

Foreign investors owned about 2,600 (1 percent) of the over 202,000 Oahu housing units existing as of October 1988.[2] As shown in table II.1, foreign investors purchased 2,065 single-family homes and condominiums from January 1987 to March 1988. However, according to real estate industry officials who performed studies of foreign investment, the purchases on Oahu during 1987 and early 1988 represented most of the foreign investment that had ever occurred in residential real estate in Hawaii. These officials estimated that foreign investors only owned about 500 single-family homes and condominiums prior to 1987.

[2]Total housing units as determined by the City and County of Honolulu Real Property Assessment Division.

Table II.1: Total Foreign Purchases of Oahu Residential Property, January 1987-March 1988 (by Country)

Dollars in thousands

	Type of property						
	Single-family homes		Condominiums		Total		
Country	Number	Amount	Number	Amount	Number	Amount	Percent of total amount
Japan	275	$299,552	1,607	$298,522	1,882	$598,074	93.9
Canada	3	1,168	88	12,354	91	13,522	2.1
South Korea	3	2,685	8	1,122	11	3,807	0.6
Hong Kong	6	1,490	11	1,674	17	3,164	0.5
Taiwan	0	0	3	582	3	582	0.1
Others[a]	10	7,554	51	10,161	61	17,715	2.8
Total	**297**	**$312,449**	**1,768**	**$324,415**	**2,065**	**$636,864**	**100.0**

[a]Country of origin was not determined by Locations, Inc., for these purchases.

Source: Locations, Inc., a Hawaiian real estate company.

A small number of investors, primarily corporations, accounted for about half of the foreign purchases of residential properties on Oahu. Overall, 1,244 foreign individuals or corporations purchased residential properties in Hawaii from January 1987 through March 1988. Of the 190 foreign investors who purchased the 297 single-family homes, 29 (15 percent) bought more than one home. Multiple-unit buyers accounted for 46 percent of the 297 homes bought by foreign investors. Overall, 25 of the 29 investors that bought more than one home were corporations. Of the 1,054 foreign investors who purchased condominiums, 118 (11 percent) bought more than one unit. Multiple-unit buyers accounted for 47 percent of the 1,768 condominiums bought by foreign investors. Sixty-one of the 118 investors that bought more than one condominium were corporations.

Area and Price Range of Purchases

While foreign investors bought over 2,000 properties on Oahu, they mainly purchased high-priced single-family homes and condominiums in certain areas. About 85 percent of the foreign investor single-family home purchases in 1987 and early 1988 were in East Honolulu neighborhoods, where about 21 percent of the single-family homes on Oahu are located. According to State of Hawaii officials, these neighborhoods traditionally have experienced greater U.S. mainland and foreign investment activity than other neighborhoods. Over 80 percent of the condominiums that foreign investors purchased during this time were in the popular Waikiki area, where approximately 21 percent of Oahu's condominiums were located. According to a manager for a local real estate firm, foreign investors bought property in Waikiki so they could

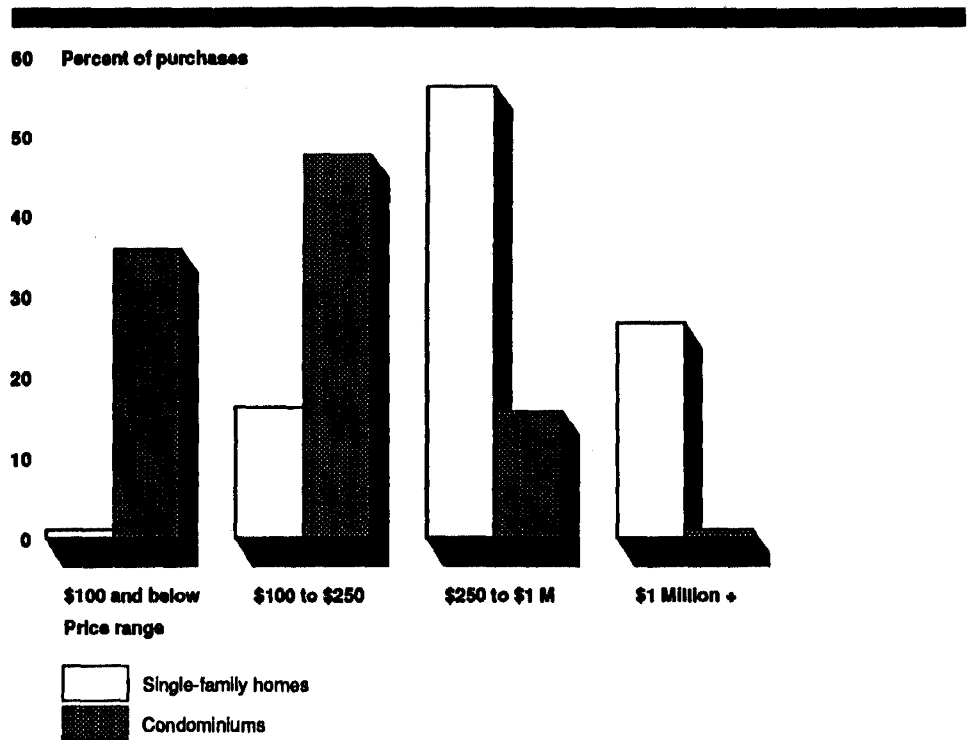
be near the area's tourist amenities and so they could rent to vacationers.

Foreign investors purchased mainly high priced single-family homes in prestigious neighborhoods (such as Kahala and Hawaii Kai) but bought more moderately priced condominiums on Oahu during 1987 and early 1988. While the median price for a single-family home sold on Oahu in 1987 was $185,000,[3] the median price in Kahala was $550,000, and the median price of the homes foreign investors purchased was $675,000. In total, about 83 percent of the single-family homes foreign investors purchased cost over $250,000. In contrast, the median price of the condominiums foreign investors purchased was $133,000, while the median price of all condominiums sold on Oahu in 1987 was $104,500.[4] About 83 percent of the condominiums foreign individuals or corporations bought were priced below $250,000, with over one-third of the units purchased for less than $100,000 (see figure II.1).

[3]According to the Honolulu Board of Realtors' Research Department's calculation of the median price of the 3,179 Oahu single-family homes sold through the Multiple Listing Service in 1987.

[4]According to the Honolulu Board of Realtors' Research Department's calculation of the median price of the 5,508 Oahu condominiums sold through the Multiple Listing Service in 1987.

Figure II.1: Total Foreign Purchases of Hawaiian Residential Real Estate (by Price Range)



Source: Data from Locations, Inc., a Hawaiian real estate company.

Agricultural Land

Foreign investors owned at least 56,692 (3 percent) of the 2 million acres of privately held agricultural land in Hawaii as of December 1988. The number of foreign-owned acres, which had an estimated value of $79.1 million in 1988,[5] has remained fairly constant since 1981. Most land was located on the island of Hawaii and owned by investors from the Netherlands Antilles.

Foreign agricultural land holdings in Hawaii did not increase substantially in 1986 and 1987, a period of heavy foreign investment in the state. From 1981 to 1988, foreign ownership of privately held agricultural land in Hawaii ranged from 52,372 to 59,812 acres but remained steady at about 3 percent of the total privately held agricultural land in Hawaii. In comparison, only about 1 percent of the privately held agricultural land nationally was foreign owned. Hawaii had the third

[5]Includes the U.S. Agriculture Department's adjusted current value of $57.7 million in 1988 plus the purchase price of $21.4 million for three properties not included in the 1988 Agriculture Department statistics.

highest percentage of privately held acres owned by foreign investors; Maine and Oregon ranked first and second, respectively.

As shown in table II.2, about 77 percent of the foreign-owned agricultural land acres in the state was registered to investors from the Netherlands Antilles. However, the Netherlands Antilles is an "identity haven,"[6] and the actual nationality of the real owners of foreign-held agricultural land was not known.

Table II.2: Foreign-Owned Hawaiian Agricultural Land by Country in 1988

Country	Acres owned	Percent of foreign-owned acreage
Netherlands Antilles	43,703	77.1
Japan	6,992	12.3
Netherlands	3,330	5.9
Hong Kong	1,279	2.3
Canada	957	1.7
Others[a]	431	0.8
Total	**56,692**	**100.0[b]**

[a]Includes Australia, South Korea, the Philippines, and Taiwan.

[b]Total does not add to 100 percent due to rounding.

Sources: U.S. Department of Agriculture and University of Hawaii Real Estate Center.

Most of the acres owned by foreign investors were on the island of Hawaii, and the majority of the agricultural land foreign investors own was used for cropland. About 50,900 (92 percent) of the 56,692 foreign-owned acres in Hawaii were located on the island of Hawaii, and 4,400 acres (8 percent) were on Oahu. About 34,000 acres (61 percent) were used for cropland; 12,300 acres (22 percent) for pasture land; and 9,600 acres (17 percent) for orchards, forest land, homesteads, and other purposes.

[6]Identity havens are countries whose laws place restrictions on revealing the identities of owners or shareholders of corporations through such means as issuance of bearer bonds or allowing citizens or other countries to funnel investments through "shell" or paper corporations established in that country in order to prevent the disclosure of the investors' identities.

Foreign Investment Had Both Positive and Negative Impacts

According to government and private officials, foreign investment increased capital and government revenues and created employment in the tourism and construction industries. Foreign investors also may have improved the competitiveness of Hawaii's visitor industry. Not all impacts of foreign investment, however, were positive. Some government and private officials were concerned that foreign investors might reduce local management influence over business decisions and expatriate profits earned locally. In addition, some officials said that foreign investors might not adequately compensate local governments for the increased demands on the state's infrastructure and that extensive development could change the character of the islands. Also, foreign residential property purchases may have increased housing prices, reducing local residents' ability to buy homes in Hawaii. Finally, some county officials said that purchases of agricultural land might decrease the construction of affordable housing in Hawaii and limit agricultural development in the state.

Assessing the impacts of foreign investment is difficult because government and private officials provided conflicting views on how extensively foreign investment affected Hawaii. For instance, some officials disagreed on the significance of profit expatriation by foreign-owned local firms, the quality of jobs created by foreign investment, and the amount of influence foreign investment exerted on housing prices. In addition, officials had conflicting views on how foreign investment affects the housing supply and landlord/tenant relations.

Data to identify the exact impact of foreign investment in Hawaii were often not available. For example, both state and county officials believed that foreign investor purchases had increased government tax revenues. However, neither the Hawaii Department of Taxation nor the Honolulu County Finance Department[7] could identify how much of the increased tax revenue was due to foreign investment. Government and private officials also believed that foreign investment increased employment in the state but could not estimate the actual number of jobs created. Officials also could not provide information on the total value of business renovations and changes in the number of properties available for rent in the state.

Recognizing the lack of data on the specific impacts or on the overall effect of some foreign investments, government and private officials

[7]The City and County of Honolulu maintain an automated property tax record system for all four counties in the state.

identified several issues they believed should be studied. For example, state, county, and private officials expressed interest in analyzing (1) the ultimate disposition of profits earned by foreign-owned local firms, (2) the coverage of costs of development by foreign investors through payment of impact fees, (3) the amount of government revenues generated by foreign investment, (4) the effect on management and employees of local firms that were bought by foreign investors, and (5) the differences in the extent to which foreign and domestic companies used local suppliers.

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